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HOUSE COMMITTEE ON FINANCIAL SERVICES
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Chairman Oxley, Ranking Member LaFalce, members of this Committee, I welcome this opportunity to present my views on reform of the International Monetary Fund (IMF), the World Bank, and the other multilateral development banks (MDBs). I also look forward to hearing your views, to answering your questions, and to discussing these important issues with you.

I believe that we now have a great opportunity to explore ways to reform the international financial institutions, and we must make the tough decisions that will bring about these needed reforms. This is our fiduciary responsibility to the American people who pay the taxes that go to fund these institutions.

I believe that the international financial institutions have an important role to play in the world economy. They can deal with critical problems facing the international financial system, and they can improve the standard of living of people around the world. But I also believe that they can do a much better job than they have done in the past. I want them to be more often associated with success than with failure.

I recognize that reform of these institutions has been a concern of many people and that informative congressional hearings and reports have been completed. Thanks to this work, useful reforms have been proposed. Some of these have been implemented. But there is still much to do.

The International Monetary Fund

I believe that the core objectives of the IMF are to (1) promote sound monetary, fiscal, exchange rate and financial sector policies, (2) carefully monitor economic conditions, and (3) deal with critical problems in the international financial system as soon as they are detected. By achieving these objectives, the IMF can provide greater stability to the international financial system and facilitate the unimpeded exchange of goods, services, and ideas so essential for economic growth. My experience in government and business tells me that the more the IMF focuses on these core objectives, the more effective it will be. And I think there can be more focus.

Crisis prevention is essential. Crises strike when there is a failure to detect financial stresses or imbalances, or when there is a failure to make the necessary decisions to reduce the stresses and imbalances that have been detected. In reviewing past crises, it seems to me that some economists and financial analysts saw economic conditions deteriorating and that not enough was done at the time to keep crises from gathering steam. The primary responsibility for avoiding crises lies with individual countries' own policy choices. Nonetheless, we in the international community also need to make better efforts to prevent crises – both through better monitoring and through better decision making – so that the IMF devotes less taxpayer money to resolving crises. Further work is needed to identify the most relevant indicators. I hope that the creation of a new capital markets section at the IMF will in fact improve crisis prevention capabilities.

A necessary element of crisis prevention is the pursuit of sound policies and the development of robust financial sectors in each country. The adoption of standards and codes representing the accepted international best practices in financial systems – such as bank capital and supervisory standards and accounting principles – is critical.

Transparency is essential. Even the most telling information is of little use if it does not reach those who rely on it. Ensuring that these assessments capture the most relevant factors and reach the private sector quickly in an easily digested format is essential both to enable markets to make informed judgments and to give countries strong incentives to pursue sound policies. Holding back such information only means that the surprises are bigger when the information finally gets out. Big surprises lead to big changes in prices and can trigger crises.

I strongly support the efforts that many in Congress, as well as other critics of the IMF, have made to increase transparency at the IMF. The IMF is now making transparency a priority, and we are beginning to see changes. Directly through its own website and other publications, and indirectly by asking member countries to increase disclosure, the IMF has helped to increase the information available on countries' economic policies and prospects.

Accountability is essential. Steps need to be taken to increase accountability to IMF shareholders and to the taxpayers. I hope that the creation of the new independent evaluation office at the IMF will in fact increase accountability.

It is also essential that the IMF not create expectations that reduce the incentives for countries and for individuals to take policy actions that are essential to prevent crises. Whenever possible, policy actions should be taken prior to the start of IMF programs. Expectations of continued or additional financial support in the case of poor policy decisions in a country reduce the incentives to make good economic decisions. Moreover, expectations that countries can and will use IMF financial support to meet payments on debt instruments held by the private sector reduce the due diligence that is required to make sound financial decisions. These perverse incentives associated with expectations of large and long-duration IMF funding are compounded if funding is provided at interest rates well below market interest rates.

The actions taken in November to change IMF lending policy are a good step toward reform. By raising the rate of interest charged for large loans and shortening the expected period of time that loans will be outstanding, the IMF can create stronger incentives for countries and private investors to make the right decisions. I hope to see such policies actually used in practice by the IMF. The new Contingent Credit Line (CCL) will also carry higher interest rates, and I like its emphasis on prior actions or pre-qualifications, which will reduce the likelihood of financial crises and contagion. Again I hope to see this new type of loan used in practice.

It is also essential for the IMF to focus its work on areas in which it has expertise and responsibility. In the past I believe that the IMF got involved in a much too wide set of policies in borrowing countries. It went well beyond relevant macroeconomic reforms within its expertise, and this of course increases the likelihood of giving poor advice. The long list of conditions attached to the IMF loan to Indonesia in the late 1990s is an important example. The IMF is now reviewing the conditions it attaches to its programs; I support the effort to sharpen the focus of these conditions. It is essential that the conditions, including prior actions, maintain the integrity and accountability of the Fund.

The Multilateral Development Banks

Like the IMF, the World Bank and the other multilateral development banks should also have a clear set of objectives. In my view their number one priority should be to raise the standard of living of people throughout the world. History tells us that the driving force behind increases in income per capita is rising productivity – the amount that each worker can produce.

If you look at per capita income in different parts of the world, the disparities between countries are clear. Virtually all of those differences can be explained by differences in productivity. Poor countries are poor – poverty exists – because productivity is low in these countries. If we are really going to reduce poverty, there is simply no alternative to increasing productivity in poor countries. I can tell you from my own experience in business that the opportunities for increasing productivity are now greater than at any time in history. The technology and the ideas are there. The challenge is to spread these ideas and to use them.

I believe that the scope of the World Bank has been too diffuse, and this reduces its focus on the core objective of raising income per capita. In the case of each new loan, each new grant we need to ask: how is this decision going to raise income per capita, or raise productivity? Economic research and historical experience tell us that more and better education is an essential ingredient for higher productivity growth. I would like to see the MDBs place greater emphasis on education. President Bush has made education a top priority for the U.S. economy. It should also be a top priority for the world economy.

Productivity can also be increased through more capital and better technology. Entrepreneurial activity in the private sector is what will make these productivity increases happen. Open markets, free trade, low tax rates and sensible regulation – the keys to U.S. growth over the past 20 years – are essential to sparking such entrepreneurial activity and, therefore, productivity. I also believe that greater priority should be given to strengthening the rule of law and promoting good governance. Assessments of borrower fiduciary policies should be central and done prior to any grants or loans. Eliminating corruption should factor more directly in Bank lending decisions.

In addition to these external changes, internal MDB governance should also ensure compliance with approved policies and maximize transparency. We must achieve stronger internal oversight mechanisms to oversee compliance with internal policies and broader information disclosure practices to enhance accountability.

When we recommend that these institutions become more focussed, we must also provide guidance on areas that can be scaled back. I am not of the view that each MDB must be a full-service “supermarket” for the developing world. Each of them could, for instance, focus their lending and grants on essential development goals. While we will be working to give some direction on this front in the coming months, cultural heritage projects that have a peripheral development impact and large infrastructure projects that could easily attract private finance are some areas that come to mind. We also have questions about MDB involvement in sophisticated electronic information sharing systems that may duplicate work being undertaken by the private sector and that do not take into account the more basic information and capacity improvement needs of these countries.

I also believe that the MDBs should focus their resources more on countries that do not enjoy access to private finance, recognizing that many other countries' financing needs are more suitably met through the private markets.

I can also see scope for differentiated loan pricing to achieve better prioritization of lending to middle income countries and better incentives for these countries to rely on private markets. In some cases, we should provide more grants. Grants should be tied to performance. Grants are also more transparent than loans that are not likely to be repaid. If it is a grant we should call it a grant and not a loan.

I also believe that the multilateral development banks can improve their coordination. More work is needed to bring greater consistency where more than one institution is operating in a particular country. The MDBs need to do a better job of sharing ideas and lessons learned about what works and what does not work.

I will also press for results-based performance indicators. We need to know more about what we are getting for our money. I see greater scope for prior actions in loans. We should certainly not increase budget support without evidence that it yields higher development effectiveness and without a clear assessment of its operational and fiduciary risks.

Conclusion

Reform of the international financial institutions is a key priority for the Bush Administration. I have given you some of my views, and I look forward to hearing more about yours. I can promise you that we will dedicate ourselves to these reform goals.

Because these institutions are international, reforming them means working closely with the other shareholders. We at Treasury are now in close contact with our colleagues from around the world to review the work of the IMF and World Bank. I am optimistic that there will be real reforms.